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Summary of the Federal Trade Commission Report on the International Petroleum Cartel

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Part I Resources and Concentration of the World Petroleum Industry.

Chapter I. The World's Petroleum Resources

This chapter is based mainly on 1948 figures and gives reserves, production and refining capacity by country and consumption figures. It also covers the principal movements of petroleum international trade in petroleum for 1948. This chapter makes no contribution of its own to the general literature in this field.

Chapter II. Concentration of Control of the World Petroleum Industry.

Control over the international oil industry is largely in the hands of seven integrated companies. These seven international companies operate through layers of jointly-owned subsidiaries and affiliated companies. Through this corporate complex of companies, they control not only most of the oil, but also most of the worlds foreign petroleum refining, cracking, transportation, and marketing facilities (outside USSR). Outside of the U.S. and USSR satellites, they accounted for 88 per cent of the world crude production, 77 per cent of refining capacity, 85 per cent of the cracking capacity. In 1948 the large companies owned or controlled about two-thirds of the privately owned tanker fleet. All of the important pipelines outside the United States are owned by these seven companies. Joint ownership of affiliated companies in 1950 is probably more widespread in the international petroleum industry than in any other field of enterprise. The international companies, operating in the United States and Canada, are joined with the large domestic oil companies in the control of pipe lines and companies holding patents on technological processes, operations where control is likely to exert the maximum of influence on the industry.

It would be difficult to overlook the significance of the meeting together of directors of the major international oil companies to determine the price and production policies of companies whose operations must inevitable affect the oil industry throughout the world. Control through the joint-ownership device is further centralized and unified by the fact that directors of the major companies also serve as directors of some of the more important affiliated companies, including indirect interlocking directorates on the U.S. oil industry. This close association of policy making officials can readily result in a unified management of the various combination of interests, and this tends to lessen the opportunity for effective competition between the major companies in their foreign operations, and at least provides an opportunity for reconciling differences that may arise between the international and the domestic companies.

The concentration of an industry into a few hands may be regarded as the sine qua non of effective cartel operations.

Part II Development of Joint Control over the International Petroleum Industry (Historical)

Chapter III. Development of Joint Control over Middle East Oil.

After 1920 American companies became actively interested in foreign reserves,

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spurred by the dual fears of a prospective shortage of American oil and of a British-Dutch monopoly of foreign reserves. This increasing interest was also stimulated by the rising costs of American oil and the current and prospective discoveries of large foreign reserves which would afford to their owners a ready supply of cheap oil, advantageously located to important consuming markets. This growing interest was transformed into successful effort by the American oil companies in acquiring substantial oil reserves in South America, particularly Venezuela, and in the Middle East. This control over foreign reserves has been achieved through the use of two techniques, joint ownership and long-term contracts for the sale of crude oil.

Chapter IV. Joint Control Through Common Ownership, The Iraq Petroleum Co., Ltd.

The Iraq Petroleum Company Ltd. (this company was known at frist as the Turkish Petroleum Company) was the first joint venture in which important American and foreign oil companies were united in one operation. The history of IPC, which is probably more tangled and dramatic than that of any other oil company, reveals that restrictive influences were at work from its inception.

In 1914 a meeting of German and British interests at the British foreign office laid the basis for the "Self-Denying" clause under which the parties agreed not to produce of manufacture oil in the Ottoman Empire (excluding Kuwait, Egypt, etc.) except through the Turkish Petroleum Company either directly or indirectly. In 1920 under the San Remo Agreement the German share went to the French Government.

The American Government waged a determined diplomatic battle with the British regarding the rights of American oil companies to participate in the development of Middle East oil resources. At that time the U.S. argued the "open-door" policy urging free access to concession areas. The oil companies' efforts to get into the Middle East were not confined entirely to Government supported methods. In 1922 the American companies were invited to meet with the Turkish Petroleum Company, but it was not until 1928 that the American group's share in the Turkish Petroleum Company was finally settled. The French, British and U.S. Governments took an active part throughout this period.

The "open-door" policy as advocated by the American companies was gradually whittled away. Their support of this policy diminished when TPC obtained an actual concession in Iraq and it was clear the American companies would not be able to obtain a concession of their own. At the same time Venezuela was developing as an important producer and oil shortages disappeared in the U.S. Mr. Gulbenkian and the French were the strongest in insisting on the Self-Denying clause since they had the least chance of getting additional concessions. An important oil discovery in Iraq hastened the conclusion of a compromise agreement which virtually closed the "open-door" since TPC became both judge and jury with regard to the areas that were considered open for new concessions and could outbid the American companies in any case.

TPC had thus

TPC has thus an exclusive monopoly of the oil concession and production rights in Iraq; it eliminated competition between the owners of TPC oil concessions in a much larger area. No plots were ever submitted for competitive biddings as TPC used various tactics to forestall a selection.

The American companies insisted on a working agreement (Red Line Agreement 1928) to control the internal policies and operations of TPC to avoid competition of TPC with existing oil companies and the payment of taxes on the earnings of TPC. Mr. Gulbenkian had to be bought off by arranging to take care of his share of the crude, among other things, in order to make TPC into a non-profit making crude oil distribution company. Crude was disposed of to its owners at cost, and profits thus went to the partners and not TPC. Refining operations were restricted in much the same manner as their right to seek concessions and engage in production. Among other things, each party was entitled to a share of the refined products on equal terms in the "basic proportions" of TPC composition.

In March 1931 TPC signed a new agreement with the Iraq Government which completely closed the "open-door" by extending their concession area from 192 square miles to 32,000 square miles and relieved TPC of all drilling obligations, present or future, and TPC was given a completely free hand in developing the concession. In return, TPC was to build a pipe line by December 31, 1935, and to supply Iraq at agreed prices.

Operations from 1927-1939 were chiefly concerned with the rate of development of the Iraq concessions. It took the companies from 1927, when oil was discovered, to 1934 to start commercial operations. In addition to the natural handicaps, some of the groups appear to have employed deliberate stalling tactics in order to retard exploration and development. Royal Dutch Shell, Anglo Iranian and the American groups had a general interest in "curtailing" world oil production" as they had substantial production elsewhere. Mr. Gulbenkian and the French on the other hand wanted maximum TPC production. The delaying tactics employed included prolonging negotiations with the Iraq Government, controversy over the route of the pipe line, delays in negotiating way leases and in construction after the route was selected, deliberate reductions in drilling and development work, preemption of concessions to keep out other interests, and simply "sitting on" concessions once they are obtained.

The British and American groups contended that TPC was bound to produce only as much oil as the groups would absorb, and that TPC had to consider, before producing the oil, how much the groups would take and how much of the remainder, if not taken by the groups, the market would absorb, and at what price. The French contended the TPC was bound to produce to the capacity of the existing pipe line, and in fact wanted additional pipe line capacity built. They maintained Iraq was made to bear the entire cutback while Iran and Venezuela were permitted to expand. The delaying tactics of TPC are shown by the relative position of Iraq with other areas such as Kuwait, Iran and Saudi Arabia.

TPC has

IPC has developed none of its concession areas rapidly - Basrah, Mosul, Qatar, Syria, Palestine, Trans-Jordan, etc. In Qatar, production began 18 years after the first well was completed; in Syria wells were deliberately drilled so that oil would not be discovered. IPC's reputation for obstructionism had become firmly established throughout the Middle East. IPC preempted a large number of smaller concession areas such as Trucial Coast, Oman Dhofar, etc. No oil has been discovered in these areas as yet. Recently IPC has abandoned some of these.

Bahrein Island and Saudi Arabia.

The discovery of oil by Standard of California in Bahrein and Saudi Arabia brought dismay to the three major groups in IPC by threatening to upset Middle East oil relationships, but restrictions on individual action by the participants of the Red Line Agreement complicated efforts to bring it under control. The efforts lasted over a seven year period. Gulbenkian and the French were suspicious of the other groups. The Red Line Agreement thus backfired when the groups wanted to forestall competition by a non-member. In 1937 California sold one-half interest to Texas in return for one-half interest in Texas marketing facilities and the new company Caltex was formed. The war interrupted the efforts of the various IPC groups to reach a basic agreement with Caltex, but some sort of agreement, for the purchase of products, had been arrived at prior to that time.

The war led to the disruption of the Red Line Agreement since the two chief proponents, Gulbenkian and the French, were eliminated as enemy aliens from participation in IPC affairs. This dispute within IPC was brought to the courts, but rather than having their affairs aired in public, the opposing groups were bought off and the matter settled out of court. A new agreement called Heads of Agreement and Supplemental Documents was signed on November 3, 1948. The new agreement eliminated most of the restrictive provisions of the Red Line Agreement and permitted Standard and Socony to become partners with Caltex in ARAMCO. The groups agreed to provide the necessary additional facilities to expand production in accordance with a planned program, arrived at a formula for pricing and provided for the disposal of the oil.

The Tripoli refinery brought IPC for the first time directly into refining and marketing. Its policies here made it unmistakably clear that the underlying motives and intentions of the IPC groups were to keep prices in line, maintain strict controls and in general operate in accordance with cartel principles.

Chapter V. Other Common Ownership in the Middle East Arabian American Oil Company - Saudi Arabia.

Standard of California was a newcomer to the international market at a time when the world oil situation was being molded to conform to a definite pattern of cooperation, which included limitations on production, sharing of markets, stabilization of prices, etc. Since it was not entitled to a share of the market on its own right, to solve its marketing agreement it formed a joint corporation

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with the Texas Company which had established markets in the Far East. At the end of the war the Far Eastern markets alone were not sufficient to take care of production. Additional markets were opened up in such a manner as not to disturb world markets. The Texas Company sold its European marketing facilities to Caltex. Caltex permitted Standard Oil of Jersey and Socony Vacuum to purchase a share in the Saudi Arabian operations which led to the formation of ARAMCO. Jersey and Socony Vacuum entered into contracts to buy oil from ARAMCO. A shift of supply was thus arranged without disrupting established marketing positions.

Kuwait Oil Company

The Gulf Oil company formed a 50-50 partnership with AIOC to develop the Kuwait oil concession. The contract establishing the operating company contained a provision that neither party would use oil from Kuwait to upset or injure the others "trade or marketing position directly or indirectly or at any time or place". If Gulf wished to purchase oil in excess of the amount desired by Anglo-Iranian, AIOC reserved the right to supply Gulf's requirements from Persia or Iraq if it wished instead of Kuwait. Gulf also made a long term contract with a Shell subsidiary to sell a large quantity of its Kuwait oil.

Chapter VI. Joint Control Through Purchase and Sale of Oil in the Middle East.

Throughout the world the "Big Seven" oil companies buy and sell among themselves, through contracts to purchase and sell large quantities of both crude and refined products. These are not ordinary commercial agreements but provide another basis for joint control over oil production and marketing. These contracts channel oil in the hands of firms able and interested in maintaining world prices and markets. The mutual interests are shown in the unusual terms as to price which are agreed upon by the parties.

Under the Gulf-Shell contract no price is stated, but elaborate provisions are written providing for the division of profits between the two parties. The profits are determined and shared for the entire integrated process of producing, transporting, refining and marketing for a minimum period of 12 years. Thus, to all intents and purposes, Gulf and Shell are joined together in a long-term integrated oil enterprise.

The Anglo-Iranian long-term contracts are based on "cost plus" pricing principles. Such a pricing principle gives the purchaser a direct and strong interest in the costs of the seller, since the purchaser will benefit from any economies achieved by the seller in his operations. The contracts contained extensive provisions in the contracts setting forth the method for determining and allocating costs and for the delivery by Anglo-Iranian of "any and all information" relating to the cost elements entering into the price which Jersey and Socony might "reasonably" request.

The Gulf-Shell Agreement also contained detailed instructions specifying the market territories in which Shell could distribute oil and the marketing

organizations

organizations through which the oil would be sold. The historic marketing provisions were thus observed, but Gulf was able through profit-sharing to participate in Shell's marketing territories.

The Anglo-Iranian contracts also contained marketing restrictions. Not more than 5 per cent of the oil could be distributed "east of Suez". The agreements also specified that the oil was to go to Europe and Africa in one case and the United States in another.

Chapter VII. Joint Control Through Purchase and Sale of Oil in Venezuela.

In Venezuela the contracts made between the oil companies were of a far more comprehensive nature than in the case of the Middle East, welding the interests of the parties together in an explicit joint enterprise lasting for the life of the concessions owned by the joint enterprise. Sizeable discoveries of oil in Venezuela led to an agreement between Standard, Shell and Gulf which (1) virtually eliminated Gulf as an independent firm in Venezuela by turning Gulf's subsidiary into a joint enterprise with Shell and Jersey and by the attendant surrender by Gulf of valuable management prerogatives, (2) set up a production quota system to see that Venezuela output would, at all times, accord with the current world market situation as seen by the producing companies.

The management prerogative rights surrendered by Gulf on behalf of its subsidiary Mene Grande to International (Jersey subsidiary) included the right of access to and inspection of all its properties, records, bodies of accounts, and all information, including geological, in its possession relating to its concessions and properties. Budgets of capital and operating expense and statements of operating policy for all its properties and interests have to be submitted annually for the approval and concurrence of International, such approval being necessary for all exploration and development work other than that in connection with current and "normal" operation. It was agreed to fix production quotas starting in 1938 but these were canceled in 1943. International admitted Shell to these supervision rights on a substantially equal basis. Gulf was paid a large amount in cash in the transaction. The arrangements were thus not ordinary business transactions. The "sale of oil" features of the contracts would appear actually to be a sharing of oil among the three companies, while the contracts themselves appear to have been designed to further the regulation and control of the development of crude oil production in Venezuela.

Part III. Production and Marketing Agreements.

Chapter VIII. Production and Marketing Agreements Among International Oil Companies.

The Standard Oil Company of (New Jersey) group, the Royal Dutch-Shell group, and the Anglo-Iranian Oil Company, Ltd. group were the primary movers behind four international oil agreements, dated from 1928 to 1934 and efforts to implement them. The immediate background for the first international agreement in 1928 was a price war between Shell and Standard Oil of New York in India, which promptly spread to the United States and European markets, where it severely affected or threatened to affect, the financial interests of all major and minor companies. After this controversy was settled, the heads of the three major groups met and negotiated the Achnacarry Agreement of 1928.

This agreement was essentially a declaration of principles and procedures by which the three majors hoped to forestall in the future similar outbreaks of competition, both among themselves and with others. The heart of this agreement was a group of seven principles to govern group action. These principles, collectively called "as is", were:

(1) Acceptance by the participants of their "present (1928) volume of business and their proportion of any future increase in consumption".

(2) Joint use of existing facilities.

(3) Construction of only such additional facilities as were necessary to supply increased demand.

(4) Production to retain the advantage of geographical location on the basis that "values of products of uniform specifications are the same at all points of origin".

(5) Supplies to be drawn from the nearest producing area.

(6) Excess of production over consumption to be shut in by producers in each producing area.

(7) Elimination of any competitive measures or expenditures which would materially increase costs and prices.

These principles were never formally abandoned. On the contrary, in subsequent agreements intended to implement them in whole or in part, "as is" was said to be of such a durable nature that failure of the subsidiary agreements to accomplish

their

their objectives, or even their total abrogation by some parties, should not prevent further joint effort to find a basis on which to make "as is" effective.

The experience of the three principle international companies during the first two years of operation under the Achnacarry Agreement were such as to make it clear that their control over the major sources of production outside the United States and Russia was, by itself, insufficient to serve as a basis for worldwide stabilization of the market. They could not always agree among themselves and there was an increasingly important uncontrolled fringe of producers and marketers of various nationalities who were not bound by the main agreement. The activities of outside producers seldom were worldwide, but by cutting even slightly under the cartel's prices in those markets in which they were interested, the outsiders became the beneficiaries of the cartel's program. If the cartel sought to drive such unwelcomed outside competition out of one market by price competition, the independents had the tactical advantage of being able to retaliate in other markets in which they previously had not been factors. The effort to stabilize the industry through a single worldwide agreement, therefore, demonstrated the difficulty of aligning diverse interests under a single agreement, and the insufficiency of the dominant position of three companies in world production and distribution to serve as the basis for effective cartel controls in local markets.

The Big Three conferred late in 1929 in an effort to implement the principles of their 1928 agreement. The result was the memorandum for European markets of January 20, 1930, in which the three major international companies set out the terms upon which they agreed to act as a unit in attacking the problem of world control (a) through agreements among themselves and with others to control production in particular producing areas and (b) through marketing agreements involving themselves and others in particular consuming countries.

Difficulties with Roumanian and Russian producers under the "as is" agreement led to the development of a new set of rules under an agreement known as "Heads of Agreement on Distribution" which was adopted on December 15, 1932 at a meeting attended by representatives of Socony Vacuum, Jersey, Anglo-Iranian, Shell, Gulf, Atlantic and Texas. The new agreement provided greater elasticity in the application of the Achnacarry Agreement's quota provisions by (base year 1928) setting out in detail the manner in which the participants to the main agreement would contribute from their

quotas

quotas in local markets to make room for larger production quotas granted to outsiders, as had been done in the case of Roumanian producers. Committees were set up in London and New York to handle its implementation. The "as is" principle was to apply everywhere except the United States.

Little was accomplished under this agreement with American production uncontrolled, a sharp drop in f.o.b. Gulf prices in the early '30's, and local resistance developing. A new draft memorandum of principles was negotiated in June 1934 to clarify the positions of the principals with respect to each other. Methods of dealing with conditions that had proved troublesome were in particular spelled out. The new agreement was much more detailed with respect to restrictions on production, division of markets, price fixing, and methods of competition.

The beginning of the war ended the formal activity and it is not clear whether the "as is" principles were ever really terminated since cooperation among the companies obviously continued. More than 10 years of cumulative effort to operate and extend controls under the various international agreements apparently established acceptance of the durable nature of "as is" principles so that their observance among the corporately interrelated international group became practically a custom of the trade.

Chapter IX. Case Studies in the Application of Marketing Agreements in Selected Areas. (This chapter draws heavily on the Swedish oil report).

There was a widespread development of local cartel arrangements following the conclusion of the Achnacarry or "as is" agreement of 1928. There can be no doubt that most of the local cartel arrangements were guided by the international agreements. In nearly all petroleum markets of the world, outside of the United States, subsidiaries and affiliates of the three principle parties to the international agreements were predominant forces. Cartel arrangements would have been unworkable without their leadership and cooperation. The cartel arrangements universally included quota arrangements designed to freeze the market pattern in accordance with that of a "base year" or "qualifying period", which in most cases was the year prescribed in the international agreements, 1928, with later modifications.

In most cases where there were substantial "outsiders" in the market, they were brought into the cartel. These important outsiders were occasionally successful in causing

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modifications or substitutions in various "as is" provisions, but the central principle always remained.

Chapter X. Price Determination in the International Petroleum Industry.

The international petroleum companies have clung tenaciously to the Gulf plus basing point system of pricing, both in its original and modified forms, to serve two basic purposes:

(1) Eliminating differences in delivered prices among the various sellers at any given point of destination, hereby making the selection of one seller over another a matter of indifference to the buyer insofar as price was concerned.

(2) Making the relatively high United States Gulf prices the basis for both crude oil and refined products prices throughout the world.

Largely as the result of government pressures (first U.S. and U.K. Navies' purchases in the Middle East during the war, and ECA since the war) they have modified the single basing point system and made other concessions, but the existing price structure is still highly profitable to the small number of major international oil companies that dominate world production. Under the resulting price structure American companies operating in the Middle East have made substantial net profits on their combined producing, refining and marketing operations. These profits were realized under a system that:

(1) Bases delivered prices throughout the world on the relatively high U.S. costs, notwithstanding the fact that this country had become a net importer of petroleum.

(2) Uses schedules of uniform freight charges that may not have any real relationship to transportation costs actually incurred, especially by the major companies that own and control the bulk of the world's tanker facilities.

(3) Is supported and maintained by effort on the part of the major international companies to adjust production to world demand. Joint ownership and private agreements in foreign countries and the conservation movement in the United States all facilitate these efforts.

The propriety of continuing into the future thus pricing system has been questioned by industry spokesman themselves. (i.e. Dr. Frankel)

I. The following three companies of British nationality control the entire oil reserves of Iraq:

1. Iraq Petroleum Co., Ltd. (formerly Turkish Petroleum Company) - 75-year concession in provinces of Baghdad and Mosul east of the Tigris River granted in 1925 as a revival and revision of concessions granted by Turkey before World War I.

2. Mosul Petroleum Company. (formerly British Oil Development Company) 75-year concession covering the area west of the Tigris River and north of Lat. 33°, originally granted to British Oil Development Company in 1933.

3. Basrah Petroleum Co., Ltd. - 75-year concession covering the province of Basrah, granted in 1938.

	Percent
Royal Dutch-Shell Co. (British & Dutch)	23.75
Anglo Iranian Oil Co., Ltd. (British)	23.75
Compagnie Francaise DesPetroles (French)	23.75
Near East Development Co. (American) representing:	
Standard Oil Co. (N.J.) 11.875%	
Socony-Vacuum Oil Co. 11.875%	23.75
C.S. Gulbenkian (Syrian individual of British Citizenship)	5.00
Total	100.00

II. Anglo-Iranian Oil Co., Ltd. (originally Anglo-Persian Oil Co., Ltd.) Original concession to William D'Arcy in 1901 revised to a 60-year concession in 1933 covering 100,000 square miles in Iran. The company is owned by:

British Government	56.0
Burmah Oil Co. (British -Royal Dutch-Shell affiliate)	22.0
Individuals	22.0
Total	100.0

III. Kuwait Oil Co., Ltd. - 75-year concession granted in 1934, covering all Sheikhdom of Kuwait. Company is owned by:

Anglo-Iranian Oil Co., Ltd. (British)	50.0%
Gulf Exploration Co. (American-Gulf Oil Company)	50.0
Total	100.0

IV. Bahrein Petroleum Company - 55-year concession granted in 1940, covering all of Bahrein Islands and territorial waters. The company is owned by:

Standard Oil Co. of California	50.0%
The Texas Company	50.0
Total	100.0

V. Arabian American Oil Co. Originally a 66-year concession granted to Standard Oil Company of California in 1933. This concession was augmented in area in 1939 to cover a total of 440,000 square miles in Saudi Arabia and the entire concession was assigned to Arabian American Oil Company, which is jointly owned by:

Standard Oil Co. of California	30.0%
The Texas Company	30.0
Standard Oil Co., N. J.	30.0
Socony-Vacuum Oil Co., Inc.	10.0
Total	100.0

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